

Notice, under and in accordance with section 22A(4) of the Water Industry Act 1991 (as amended), of the Director General of Water Services' proposal to impose a penalty on Southern Water Services Limited

This document constitutes a notice given under and in accordance with section 22A(4) of the Water Industry Act 1991(as amended) (the "WIA91"). The background and context to this notice are set out in sections 1 to 8. This notice states that:

1. the Director General of Water Services (the "Director") proposes to impose a penalty on Southern Water Services Limited ("Southern Water");
2. the Director is satisfied that Southern Water has failed to achieve standards of performance prescribed under sections 38(2) and 95(2) WIA91, namely the standards in the Water Supply and Sewerage Services (Customer Service Standards) Regulations 1989 (as amended) (the "GSS Regulations"). The reasons for this are set out at sections 4 and 5;
3. the proposal to impose a penalty is in respect of Southern Water's failure to achieve standards of performance prescribed under sections 38(2) and 95(2) WIA91, namely the GSS Regulations, at all material times between 1 April 2005 (the date on which the Director's power to impose a penalty commenced and from which the Director's power to impose a penalty may be exercised) and the date of this notice;
4. the omissions which, in the opinion of the Director, constitute the failures in question and which justify the imposition of a penalty are set out in sections 4 to 7 of this notice;
5. however, the Director requires Southern Water to provide further information as to the extent of the failures to be able to quantify fully the amount of the proposed penalty. Southern Water has undertaken to provide the Director with that information;

6. although the Director cannot bind the Water Services Regulation Authority (the “WSRA”), which replaces the Director from 1 April 2006, it is likely that the WSRA will vary the proposal stated in this notice once Southern Water has provided information as to the full extent of the failures; if so, the WSRA will be required to give notice, as required by section 22A(5) WIA91, setting out the proposed variation and the reasons for it and allowing a period (not being less than twenty-one days from the date of publication of the notice) within which representations or objections with respect to the proposed variation may be made;
7. the Director is also considering whether Southern Water has or may have contravened conditions of its appointment by providing the Director with false information in relation to customer services and whether it would be appropriate to impose a separate penalty on Southern Water in respect of those contraventions; this notice is without prejudice to any penalty the Director or the WSRA may impose or propose to impose, or any other action the Director or the WSRA may take, in respect of any such contraventions;
8. representations or objections with respect to the proposed penalty may be made by 30 June 2006; representations or objections should be made to Sue Cox, as set out below.

Sue Cox
Ofwat
Centre City Tower
7 Hill Street
Birmingham
B5 4UA

Or by e-mail to sue.cox@ofwat.gsi.gov.uk

Representations and/or objections, which should be made in writing, should be clearly marked ‘Southern Water Proposed Penalty’.

Representations and/or objections will be placed in our library and made available to the public, unless you have clearly indicated that you do not wish this to happen. In general, we will honour this request, but there may be circumstances in which, under the Freedom of Information Act 2000, we would be obliged to disclose responses.

1. Regulatory and Legal Framework

The Director is the economic regulator for the water and sewerage industry in England and Wales. His primary duties are (so far as relevant):

- to further the consumer objective (namely to protect the interests of consumers, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the provision of water and sewerage services);
- to secure that the functions of a water undertaker and of a sewerage undertaker are properly carried out as respects every area of England and Wales; and
- to secure that undertakers¹ are able (in particular, by securing reasonable returns on their capital) to finance the proper carrying out of those functions.

On 1 April 2006 the office of the Director is abolished and replaced by a body corporate known as the WSRA (section 34 of the Water Act 2003 (the “WA03”). On the same day the functions of the Director will be transferred to the WSRA under section 36 WA03 and the Water Services Regulation Authority Transfer Scheme 2006.

Anything done by the Director for the purpose of or in connection with any of his functions and which is in effect immediately before the transfer (such as this notice) is treated as if done by the WSRA (Schedule 3, paragraph 6(1) WA03). The transfer

of the functions does not affect the validity of anything done by the Director before the transfer takes place (Schedule 3, paragraph 6(2) WA03). The WSRA is substituted for the Director in any document relating to anything transferred (Schedule 3, paragraph 8). In this case the final decision on whether, and if so in what sum, to impose a penalty will be taken by the WSRA.

2. Penalties

Under section 22A(1)(a) WIA91² the Director may impose on an undertaker a penalty of such amount as is reasonable in all the circumstances of the case where, amongst other things, he is satisfied that the undertaker:

- has contravened or is contravening any condition of its appointment;
- has failed or is failing to achieve any standard of performance prescribed under section 38(2) or 95(2) WIA91; or
- has contravened or is contravening any statutory or other requirement which is enforceable under section 18 WIA91 and in relation to which the Director is the enforcement authority.

By section 22A(10) WIA91, the power to impose a penalty under section 22A is not exercisable in respect of any contravention or failure before the commencement of section 22A, namely 1 April 2005³.

The Director may not impose a penalty in respect of a contravention or a failure later than twelve months from the time of the contravention or failure, unless before the

¹ Companies holding appointments as water-only or water and sewerage undertakers under Chapter 1 of Part 2 of the WIA91.

² Sections 22A to 22F WIA91 were inserted by section 48(1) WA03. For present purposes, section 48(1) came into force on 1 April 2005: the Water Act 2003 (Commencement No. 4, Transitional Provisions and Savings) Order 2005, SI 2005 No. 968, Article 2(i). Under Article 4 of, and Schedule 2, paragraph 4 of the Water Act 2003 (Commencement No. 4, Transitional Provisions and Savings) Order 2005, until the coming fully into force of section 36(1) WA03 (transfer to the WSRA of functions, property etc) on 1 April 2006, any reference to the WSRA in sections 22A to 22F WIA91 has effect as if it were a reference to the Director.

end of that period notice under section 22A(4) WIA91 relating to the penalty is served on the undertaker under section 22A(8) WIA91.

A penalty may not exceed 10% of the company's turnover, determined in accordance with the Water Industry (Determination of Turnover for Penalties) Order 2005 (SI 2005 No. 477). That Order provides that the turnover of the company is the applicable turnover for the last business year preceding the date on which the Director gives notice under section 22A(4) WIA91 (i.e. the date of this notice), where the applicable turnover is broadly the turnover derived from the company's regulated activities.

The 10% limit applies to each breach for which a penalty is imposed, rather than representing a cumulative limit for a financial year.

As he is required to⁴, the Director has prepared and published jointly a Statement of Policy with the Secretary of State for the Environment, Food and Rural Affairs and the National Assembly for Wales with respect to the imposition of penalties and the determination of their amount (the "Statement of Policy")⁵. In deciding whether to impose a penalty, and in determining the amount of any penalty, the Director must have regard to the Statement of Policy most recently published at the time when the contravention or failure occurred.

Penalties are paid into the Consolidated Fund and are not returned to customers⁶.

The Director shall not impose a penalty under section 22A WIA91 where he is satisfied that the most appropriate way of proceeding is under the Competition Act 1998. The matters with respect to which the Director proposes to impose a penalty relate to failures to achieve standards of performance under the GSS Regulations.

³ The Water Act 2003 (Commencement No. 4, Transitional Provisions and Savings) Order 2005, SI 2005 No. 968, Article 2(i).

⁴ Section 22B WIA91, inserted by section 48 WA03. Section 22B WIA91 came into force on 1 October 2004: the Water Act 2003 (Commencement No 2, Transitional Provisions and Savings) Order 2004, SI 2004 No. 2528, Article 2(e)(ii).

⁵ "Statement of Policy with respect to financial penalties", 17 March 2005.

⁶ Section 22A(9) WIA91.

Consequently, the Director is satisfied that it would not be appropriate to proceed under the Competition Act 1998.

The behaviour in respect of which the Director proposes to impose a penalty is the failure to achieve standards of performance prescribed under section 38(2) or 95(2) WIA91. Under those provisions the Secretary of State has the power to prescribe, by regulations, such standards of performance in connection with the provision of supplies of water or sewerage services as, in his opinion, ought to be achieved in individual cases. The GSS Regulations are made under those powers.

The GSS Regulations provide that if an undertaker fails to provide certain customer services in the manner set out, the undertaker must make a payment to that customer. The standards of performance prescribed by the GSS Regulations relate to:

- Keeping of appointments – including giving notice of the appointment to the customer and offering a time slot for the appointment (Regulation 3);
- Responding to account queries and requests about payment arrangements within a certain timeframe (Regulation 4);
- Responding to written complaints from customers in connection with the supply of water or the provision of sewerage services within a certain timeframe (Regulation 5);
- Interruptions to supply – including giving adequate notice of interruptions (Regulation 6) and making payments for unplanned interruptions or those which run over the period of notification (Regulation 7);
- Maintaining adequate pressure (Regulation 7AA); and
- Flooding from sewers (Regulation 7B).

3. Background

On 21 October 2005 Southern Water informed the Director and the Serious Fraud Office (the "SFO") that it had discovered that it had been mis-reporting its customer service performance to the Director and had been failing to achieve standards of performance in customer service set out in the GSS Regulations and had not been making payments due to customers for those failures as required by the GSS Regulations.

As a result Ofwat and Southern Water jointly appointed KPMG LLP Forensic to carry out an independent investigation into these irregularities. That investigation is ongoing.

The SFO is considering separately whether to initiate its own investigation.

Southern Water is carrying out an exercise to determine, as far as possible, which customers should have received payments due as required by the GSS Regulations, and has undertaken to the Director to make those payments. Southern Water is also taking action to improve its customer service performance and the accuracy of the data it reports to the Director.

Southern Water accepts the principle that it should not benefit to the detriment of its customers from any irregularities found by the investigations. Consistent with this principle, Southern Water has given the Director an undertaking that it will pay customers in full any amounts found by the investigations to be due to customers and that if Southern Water has benefited from the irregularities in terms of its price review, it will fully adjust future prices to its customers. The undertaking also states that, in due course, Southern Water will provide the Director with a written statement that the company has adequate systems of control and internal planning to fulfil its functions and meet its obligations as an undertaker.

4. The failures

The Director's power to impose a penalty under section 22A WIA91 is not exercisable in respect of any contravention or failure before the commencement of section 22A WIA91, namely 1 April 2005.

This notice therefore relates only to Southern Water's failure to achieve standards of performance prescribed by the GSS Regulations for the period from 1 April 2005 to the date of this notice.

Separately, the Director is considering whether Southern Water has or may have contravened conditions of its appointment by providing the Director with false information in relation to its customer service performance and whether it would be appropriate to impose, or to propose to impose, a separate penalty or penalties in respect of any such contraventions. This notice is without prejudice to any penalty the Director or the WSRA may impose or propose to impose, or any other action the Director or the WSRA may take, in respect of any such contraventions.

From the evidence and information that the Director has seen to date, he is satisfied that Southern Water has failed to achieve standards of performance prescribed in the GSS Regulations during the relevant period.

Whilst the company has provided the Director with some information about its level of performance and the extent of its failure to comply with standards of performance prescribed by the GSS Regulations, that information is not yet complete. As stated above, Southern Water is undertaking work to provide further information.

5. Examples of failures to comply with standards of performance prescribed by the GSS Regulations⁷

5.1 Standard of performance prescribed by Regulation 3 of the GSS Regulations

Regulation 3 of the GSS Regulations prescribes standards of performance in relation to the keeping of appointments by undertakers. It applies where an undertaker decides to visit premises of a customer in connection with the provision of supplies of water or sewerage services which requires access for its representative or for which it would otherwise be reasonable to expect the customer (or a person acting on his behalf) to be present on the premises.

Subject to certain exceptions, the undertaker must, after consulting the customer, give notice to the customer that its representative will visit the premises on an appointed date. The notice must also specify either:

- where the customer so requests, a two hour slot during which the visit will be made; or
- in any other case, whether the visit will be made before or after 1pm.

The undertaker's representative must (again, subject to certain exceptions, including cancellation by the customer) visit the premises on the appointed date, either during the specified slot or before or after 1pm (as specified in the notice).

If the undertaker fails to meet the standard of performance prescribed by Regulation 3, it must pay to the customer (or credit to his account) the sum of £20.

Section 22A(4) WIA91 requires this notice to set out the omissions which, in the opinion of the Director, constitute the failure in question. The evidence and information provided to date show that Southern Water has failed to achieve the

⁷ Reference should be made to the GSS Regulations for the complete wording of the GSS Regulations, including the exceptions to the prescribed standards of performance.

standards of performance set out above on a number of occasions during the period from 1 April 2005 to the date of this notice.

5.2 Standard of performance prescribed by Regulation 4 of the GSS Regulations

Regulation 4 prescribes standards of performance in relation to account queries and requests about payment arrangements. It provides that, subject to certain exceptions –

- where a customer queries in writing the correctness of an account presented to him by an undertaker for the supply of water or sewerage services (“a query”), the undertaker must despatch a substantive reply to the customer within 10 working days from the date of receipt of the query; and
- where a customer asks in writing to change the arrangements by which he makes payments and that request cannot be met, the undertaker must despatch a substantive reply to the customer within five working days from the date of the receipt of the request.

If an undertaker fails to meet the standard of performance prescribed under Regulation 4, it must pay to the customer (or credit to his account) the sum of £20.

Section 22A(4) WIA91 requires this notice to set out the omissions which, in the opinion of the Director, constitute the failure in question. The evidence and information provided to date show that Southern Water has failed to achieve the standards of performance set out above on a significant number of occasions during the period from 1 April 2005 to the date of this notice.

5.3 Standard of performance prescribed by Regulation 5 of the GSS Regulations

Regulation 5 prescribes standards of performance in relation to handling complaints about water or sewerage services. It provides that, subject to certain exceptions, where a customer complains in writing to a water undertaker in connection with the

supply of water or to a sewerage undertaker in connection with the provision of sewerage services, the undertaker must send a substantive reply to the customer within 10 working days from the date of the receipt of the complaint.

If the undertaker fails to meet the standard of performance prescribed by Regulation 5, it must pay to the customer (or credit to his account) the sum of £20.

Section 22A(4) WIA91 requires this notice to set out the omissions which, in the opinion of the Director, constitute the failure in question. The evidence and information provided to date show that Southern Water has failed to achieve the standards of performance set out above on a significant number of occasions during the period from 1 April 2005 to the date of this notice.

6. Facts justifying the imposition of a penalty

In deciding whether to impose a penalty in respect of a failure, the Director shall have regard to his Statement of Policy (the Statement of Policy). The Statement of Policy states that when considering whether to impose a penalty, the Director will take account of the particular facts and circumstances of the case under consideration. This will include the extent to which the circumstances under which the failure arose were, or were not, outside the control of the company. It also states that when considering whether to impose a penalty, a penalty is more likely where:

- the contravention or failure has damaged the interests of customers or other market participants or damaged the environment; or
- applying a penalty would be likely to create an incentive to comply and deter future contraventions or failures.

On the basis of such evidence and information as has been provided to the Director to date, it appears to the Director that the failures arose under circumstances which were within the control of the company. The Director considers that customers' interests have been significantly damaged, as the failures have meant that many of

Southern Water's customers have not received the standards of performance in customer service prescribed by the GSS Regulations. The Director also considers that imposing a penalty would be likely to create an incentive to comply and deter future contraventions or failures on the part of Southern Water and other undertakers.

The Statement of Policy states that a penalty will be less likely to be imposed where:

- the contravention or failure was or is of a trivial nature; or
- the contravention or possibility of a contravention would not have been apparent to a diligent company.

On the basis of such evidence and information as has been provided to the Director to date, it appears to the Director that the scale of the failures is not of a trivial nature and that the circumstances which lead to the failures should have been apparent to a diligent undertaker.

In the light of the above factors and on the basis that the Director is satisfied that Southern Water has failed since 1 April 2005 to achieve standards of performance prescribed in the GSS Regulations, the Director considers that it is appropriate to impose a penalty on Southern Water in respect of its failure to achieve standards of performance under the GSS Regulations.

7. The amount of the penalty

Section 22B(2) WIA91 also states that in determining the amount of any penalty in respect of a failure the Director shall have regard to his Statement of Policy. The Statement of Policy sets out that any penalty must be reasonable in the circumstances of the case and that factors relevant to decisions on the broad level of a penalty will include:

- the seriousness and duration of the contravention or failure;

- the degree of nuisance, harm or increased cost incurred by customers, other market participants or the environment;
- any gain (financial or otherwise) made by the company as a result of the contravention or failure;
- precedents set under equivalent provisions for other utilities and public services; and
- the level of any other penalty already or potentially imposed through other regulatory means in relation to the same contravention or failure.

On the basis of such evidence and information as has been provided to the Director to date, it appears to the Director that the failures are serious in nature. When Southern Water has provided the WSRA with further information about (among other things) its performance from 1 April 2005 in relation to the standards of performance prescribed by the GSS Regulations, the WSRA will be in a position to consider the factors needed to determine the broad level of the penalty and the aggravating and mitigating factors as set out in the Statement of Policy.

As required by section 22A(4)(a) and (c) WIA91 this notice must state the amount of the penalty proposed to be imposed and the other facts, which in the opinion of the Director, justify the amount of the penalty imposed. For the purposes of this notice only, the amount of the penalty is the nominal amount of £1. Until the required information referred to in the above paragraph has been provided, the Director is unable to quantify the final amount of the penalty.

8. Variation of this notice

As stated above, Southern Water will provide the WSRA with further information on (among other things) its failures to achieve the standards of performance prescribed by the GSS Regulations. Although the Director cannot bind the WSRA, it is likely that the WSRA will vary the proposal stated in this notice once the further information has been provided.

The Director has decided to issue this notice now, in order to take into account all the failures to achieve the standards of performance prescribed by the GSS Regulations since 1 April 2005 when imposing the penalty. In order to do so, as a result of the time limits set out in section 22C WIA91, the Director must issue a notice before 1 April 2006.

In the event that the WSRA wishes to vary this notice, in accordance with section 22A(5) WIA91, the WSRA will be required to give notice setting out the proposed variation and the reasons for it and to specify a period (of not less than twenty-one days) within which representations or objections with respect to the proposed variation may be made.

9. Representations or objections with respect to the proposed penalty

Under section 22A(4)(d) WIA91, the Director shall give notice specifying the period (of not less than twenty-one days from the date of publication of this notice) within which representations or objections with respect to the proposed penalty may be made. Accordingly, representations or objections with respect to the proposed penalty may be made by 30 June 2006. Representations or objections should be made to Sue Cox, as set out below.

Sue Cox
Ofwat
Centre City Tower
7 Hill Street
Birmingham
B5 4UA

Or by e-mail to sue.cox@ofwat.gsi.gov.uk

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Keith Mason

Keith Mason
Director of Regulatory Finance and Competition